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Financial Markets

Irving Trust

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This week market interest rates edged up as the Federal Reserve was back in the driver's seat again after having briefly been stymied late last week by the market's excessively optimistic view of Fed policy. The problem then--as described in some detail here last Friday--was that the Fed faced a reserve-adding task in the statement week beginning June 12 that it could not carry out so long as the market danced to its own tune and traded funds at rates under the Fed's presumed 9% acceptable weekly average rate. By Monday, however, the reserve need--plus the Fed's dramatic reserve-draining operation Friday morning--had caught the market's attention, and the funds rate was safely ensconced in over 9% territory. Thus the Fed was able to pump in reserves to cover projected needs in that statement week as well as the one beginning on June 19 without seriously imperiling the 9% minimum average rate. In fact, the average effective rate for the statement week came in at 8.99%--only one basis point below the presumed minimum.

The large $2.6 billion increase in the money supply (M1B) announced last Friday probably deferred until the latter part of this month any further efforts by the Fed to speed the return of the monetary aggregates to the target paths. The market has focused almost exclusively on the gap between the lower bound of the 4%-6 1/2% target for M1B and the level of M1B--as of the week ended June 4, the shortfall was about $4 billion. However, Fed officials are probably giving more weight to the sizable closing of the gap in recent weeks. The shortfall, which was almost $10 billion on the week ended April 30, has by now been pared back by more than half. Thus Fed officials are likely to defer decisions to stimulate further until late June in order to gauge more accurately the delayed effect of the relaxation already implemented.

In this context, it is interesting to note that the growth of money market mutual fund shares has resumed its rapid pace following the interruption caused in March and April by the Fed's March 14 credit restraint program. The main reason for the resurgence is the attractive yields that the funds--both clones and non-clones--continue to pay. The pickup in growth of the money funds accounted for $4.8 billion of the $12 billion increase in M2 (which includes money fund shares) in May, although they are only about 4% of M2. Since growth of M2 was so strong in May--9.2% at an annual rate--M2 is now close to the bottom of the 6%-9% target range for the aggregate. The recent strength shown by M2--largely unnoticed by market participants--is probably also contributing to the willingness of the Fed to wait awhile before proceeding with further easing.

In reaction to the turnabout in the funds market, the rally that started late last week ran out of steam. Rates on short-term securities--especially Treasury bills--backed up over the week, while bond prices were about unchanged. Not only have some market participants become less certain that the Fed has eased--as many had proclaimed last week--but rates charged dealers to finance their securities inventories were generally punitively high relative to the rates on the securities themselves. Most of the bullish economic news received during the week--uniformly reflecting the deteriorating economy--had been anticipated and thus had little supportive effect on the market.

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Market Yields

	6/20/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(NOON)		
Short-term loans to substantial depositors with highest credit rating	12.00%	12.00%	11.50%
Effective since	6/13/80		
Discount Rate at Federal Reserve Bank	11.00	11.00	9.50
Federal Funds	9.38	8.50	10.25
Repurchase Agreements	8.50	8.00	9.55
U.S. Treasury Issues			
Bills			
3 months	6.96	6.25	9.25
6 months	7.02	6.90	9.50
1 year	7.40	7.40	9.60
Coupons			
2 years	8.59	8.20	9.26
4 years	9.00	8.55	8.95
7 years	9.25	8.75	8.90
10 years	9.47	9.40	8.92
Long Bond	9.54	9.48	8.91
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.75	8.25	9.80
3 months	8.50	8.25	9.90
6 months	8.25	8.10	10.00
1 year	8.00	8.00	10.00
Banker's Acceptances			
1 month	8.40	8.25	9.88
3 months	8.30	7.88	9.94
6 months	8.55	8.15	10.03
Eurodollar Deposits			
1 month	9.13	8.69	10.56
2 months	9.19	8.75	10.63
3 months	9.31	8.75	10.69
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.25	8.13	9.01
1 month	8.00	7.75	9.70
3 months	7.75	7.50	9.60
Bank Holding Companies			
1 month	8.38	7.50	9.63
Dealer Placed:			
3 months	8.13	7.75	9.63
New AA Corporate Utility Bond	11.00	11.00	9.65
Tax Exempt			
6 month Project Notes	3.50	3.70	4.70
1 year AAA Bond	4.90	4.60	N/A
5 year AAA Bond	5.10	5.10	N/A
20 year AAA Bond	6.80	6.50	5.80

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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